Portland Cement Association

TESTIMONY BEFORE THE

HOUSE COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

SUBCOMMITTEE ON RAILROADS

SUBMITTED BY

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ON BEHALF OF

PORTLAND CEMENT ASSOCIATION

HEARING ON

THE U.S. RAIL CAPACITY CRUNCH

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Mr. Chairman and members of the Subcommittee, my name is John White, Vice President of Logistics for Buzzi Unicem USA Inc., a leading manufacturer of portland cement in the United States. I appreciate the opportunity to testify here today to discuss issues related to rail capacity. I appear on behalf of the Portland Cement Association, of which I serve as chairman of its Logistics Committee. I look forward to a constructive dialogue addressing the need for additional rail capacity and reasonable steps we believe are necessary to improve the current national rail policy. The current national rail policy and lack of capacity impedes portland cement manufacturers from effectively and efficiently delivering an essential commodity needed to build our nation's vital infrastructure and strengthen our nation's economy. With more than 80 percent of portland cement manufacturing plants "captive" to a single railroad, the current rail policy is unnecessarily contributing to higher construction costs and in some instances making it more cost-effective to import portland cement from as far away as China.

WHAT IS PORTLAND CEMENT?

The term "portland" cement is not a brand name – rather, it is a generic name for the type of cement used in concrete, just as stainless is a type of steel. Portland cement is a manufactured powder that acts as the glue or bonding agent that forms concrete. As an essential construction material and a basic component of our nation's infrastructure, portland cement is utilized in numerous markets, including the construction of highways, streets, bridges, airports, mass transit systems, commercial and residential buildings, dams, and water resource systems and facilities. The low cost and universal availability of portland cement ensures that concrete remains one of our nation's most essential and widely used construction materials.

PORTLAND CEMENT ASSOCIATION

Portland Cement Association (PCA) is a trade association representing cement companies in the United States and Canada. PCA's membership consists of 31 companies operating 102 manufacturing plants in 36 states. PCA members account for 98 percent of cement-making

capacity in the United States. The cement industry is a crucial component of one of the largest segments of our nation's economy – the more than one trillion dollar construction industry. Nearly every construction project requires portland cement. In 2005, 127 million metric tons of portland cement were consumed in the United States; in fact, cement is the second most consumed commodity on the planet, second only to water.

BUZZI UNICEM USA INC.

Buzzi Unicem USA is the fourth largest U.S. cement company, producing 8.8 million tons of cement annually. Employing 1,600 people, Buzzi Unicem operates 10 manufacturing plant locations throughout the United States including: Cape Girardeau and Festus, Missouri; Chattanooga, Tennessee; Greencastle, Indiana; Independence, Kansas; Maryneal, Texas; Oglesby, Illinois; Pryor, Oklahoma; and Stockertown, Pennsylvania. Our corporate office is located in Bethlehem, Pennsylvania. Buzzi Unicem USA supplies cement to over 3,800 highway paving contractors, ready mixed concrete producers, concrete block producers, and other concrete product firms in 18 states. Nine of the 10 cement plants mentioned above are captive to a single railroad.

U.S. CEMENT INDUSTRY DEMOGRAPHICS

The cement industry operates manufacturing plants in 36 states, producing nearly 96 million metric tons of portland cement in 2005. Cement manufacture is a highly capital-intensive industry. Cement companies invest millions of dollars annually to upgrade manufacturing equipment and phase out more costly and less energy efficient operations. Between 1994 and 2003 the cement industry invested $7.542 billion in new capital investment. The construction and permitting costs of a new greenfield cement plant can easily exceed $250 million. Only two greenfield plants have been constructed within the past 10 years.

Cement is produced from various abundant raw materials including limestone, shale, clay and silica sand. These minerals are ground and heated in large rotary kilns to temperatures as

high as 3,400 degrees Fahrenheit. The heat of the combustion fuses these materials into clumps of an intermediate material called clinker. When the clinker is discharged from the kiln, it is cooled and later ground with a small amount of gypsum to produce the gray powder known as portland cement. Different types of portland cement are manufactured to meet various physical and chemical requirements.

Portland cement manufacturing facilities use an enormous amount of energy. In fact, energy is the largest cost component in the manufacture of portland cement. The U.S. cement industry is largely coal fired with 81.3 percent of all plants using coal, coke, or some combination of the two as primary kiln fuel in 2004. The domestic cement industry is the largest industrial consumer of coal. Much of the coal utilized to heat cement kilns on a 24/7 basis is delivered by rail.

The cement industry is regional in nature. Most cement manufacturing plants are located in rural areas near large limestone deposits, the principal ingredient in producing cement. However, at the same time plants also must be located near markets because the cost of shipping cement quickly overtakes its value. As such, customers traditionally purchase cement from local sources. Texas, California, Florida and Pennsylvania, are the leading cement manufacturing states, respectively, producing nearly 36 million tons in 2005 or 37.4 percent of domestic cement production.

U.S. CEMENT MANUFACTURERS RELY ON RAILROADS

Considering the regional nature of the cement industry, it is critical that there are reliable and cost-effective transportation options available. Average cement shipments range between 250 to 300 miles. Truck transportation is not economical beyond 100 to 125 miles. As such, the cement industry is reliant on railroads to deliver our product beyond the economical range of trucks. Several cement plants have access to water transportation for domestic shipments. The railroads have sometimes argued that these cement facilities are not captive since there are alternative modes of transportation available. This simply is not the case. Domestic portland

cement manufacturers rely on rail transportation to move 50 percent of all shipments between cement plants and distribution terminals, according to 2004 U.S. Geological Survey data, the most recent independent figures available. About 95 million tons of cement was produced domestically in the same year. Most bulk cement shipments are from the manufacturing plants to the more than 400 regional distribution terminals, where the cement is then delivered by truck to local contractors and ready mixed producers. It is vitally important to our industry that the railroads provide reliable, efficient and cost-effective service to meet the widespread demand for our product. As mentioned earlier, more than 80 percent of U.S. cement manufacturing plants are captive to a single railroad. Due to the absence of competition, these plants are charged substantially higher rates and usually receive poor service. On the other hand, dual rail-served facilities typically have lower rates and more reliable service.

The railroads also transport millions of tons of inbound coal shipments to fuel cement manufacturing plants each year. There are examples within the industry in which cement plants that are served by two railroads receive coal from a supplier that is captive to a single railroad. There are also instances where both the cement plant and the coal supplier are captive to a single railroad. These situations result in unnecessarily high rail rates that add to the cost of cement and, ultimately, to construction costs. PCA members have also reported situations in which they were forced to transport coal to the cement plant by truck, at a substantial cost, due to delivery failures by the railroad. In these instances, the situation confronting the cement plants were desperate: they had only a day or two of coal supply on hand.

U.S. CEMENT INDUSTRY LARGELY "CAPTIVE" AND SERVICE SUFFERS

The Staggers Act of 1980, which removed regulations of the railroad industry where transportation competition exists, has improved the industry's efficiency and financial stability. However, since deregulation, there has been a sharp decline from 63 Class I railroads in 1976 to just four major Class I railroads today handling 90% of the nation's rail traffic. This consolidation has contributed to diminished competition as well as ineffective and inconsistent rail service for the cement industry and many others.

Inconsistent and unreliable service from the Class I railroads is one of the most serious problems the portland cement industry confronts in our efforts to bring an affordable and essential product to market. Service encompasses many aspects of rail transportation, including picking up rail cars (covered hoppers), on-time delivery of rail cars, providing empty rail cars, handling issues, questions about the condition of the rail cars, and settling claims for service failures. The cars supplied by the railroads are typically old, poorly maintained and frequently a safety concern. Our members report that as many as 15 percent of the empty rail cars delivered to manufacturing plants in a given week are being rejected.

In recent years, several cement companies have been forced to purchase private rail cars since the Class I railroads have refused to add cement rail cars to their fleets. This, in addition to the declining and inconsistent service, has increased the need for more rail cars to deliver the same tonnage. Meanwhile the railroads have added tariff provisions charging for the storage (demurrage) of private rail cars. This results in further increased costs to the cement shipper while providing no incentive to the rail carriers to improve their service.

Further compounding the problem is the fact that at some locations, the railroad will only quote freight rates to the cement company if the cement company uses their (system) rail cars. In short, no product will move from that origin unless the railroad is collecting revenue for the use of their rail cars. In other instances, the railroads quote rates such that the difference in cost of a movement in a private rail car is so great that private rail car transports are not economical. Rail car supply is a classic Catch 22 situation that adds unnecessarily to the cost and inefficient shipment of our product and, ultimately, to construction costs.

While service continues to decline, cement manufacturers are experiencing sharp rail freight rate increases. For example, some rates increased more than 23 percent in 2005, according to some cement companies. Indeed, transit times on empty return cars have increased by more than 13 percent in some instances, increasing fleet storage costs. So, Mr. Chairman, our industry literally is paying more for less!

PCA SUPPORTS SERVICE PROVISIONS IN LEGISLATION

The cement industry has no recourse regarding rates since cement (officially "hydraulic cement") is classified as an exempt product from rate regulation by the Surface Transportation Board (STB). Since the STB has done little to address service issues, we believe Congress should enact legislation expanding the STB's authority in this area. The STB should be required to post a description of each complaint from a customer about rail service. The legislation should also require the Board to submit an annual report to Congress regarding rail service complaints and describe the procedures the Board took to resolve them. Further, either party should be allowed to submit a dispute over rail service to the STB for "final offer" arbitration. These provisions are included in bipartisan legislation (H.R. 2047), *the Railroad Competition Improvement and Reauthorization Act of 2005*. These service provisions contained in H.R. 2047 do not constitute "re-regulation," a term coined by the railroad industry to overstate the perceived negative impact of the legislation.

We believe strongly that the lack of rail competition is the fundamental issue associated with these problems. PCA believes it is important to strike a balance between regulation of the railroad industry while also assuring rail competition. PCA believes that the intent of Congress in the Staggers Act was only to deregulate the railroads where competition exists. Unfortunately, the implementation of the Act has resulted, often, in deregulation even where there is no transportation competition – with predictable results such as those we are reporting.

The following example further illustrates the unintended consequences of the Staggers Act, as implemented, on a captive shipper.

PCA member Holcim (US) Inc. established HolRail, a limited liability corporation, to construct and operate a two-mile rail line that would provide competitive rail service to the Holcim cement manufacturing plant in Holly Hill, South Carolina. Presently, Holly Hill is

served only by CSX Transportation, Inc. (CSX). The proposed line would connect to a rail line owned by the Norfolk Southern Railroad Company (NSR).

Holcim is one of the largest suppliers of portland and blended cements and related mineral components in the United States. It ships more than 20 million tons of cement and related materials each year, of which 16 percent moves by railroad. Holcim has 14 manufacturing facilities and approximately 70 distribution terminals across the country and employs approximately 2,500 people in the United States.

The Holly Hill production facility manufactures a variety of cement and masonry products and relies on rail transportation to receive inbound raw materials and to ship outbound products. In August of 2003, Holcim completed a plant expansion project that increased the size of the facility and doubled output capacity to two million tons of cement per year. A substantial portion of Holly Hill's production is shipped by rail to Holcim distribution terminals to serve markets that are over 100 miles from the facility. Because trucking cement over distances greater than 100 miles is uneconomic and impractical, Holly Hill requires reliable, economic, and efficient rail transportation to reach optimal plant utilization.

When the Holly Hill plant operates at full capacity, the plant annually receives 3,500 inbound rail cars with fuel and raw materials and ships out 10,000 rail cars with cement. As the only rail carrier with direct access to the Holly Hill plant, CSX transports all inbound raw materials and outbound products that move by rail. CSX's service track record is weak. Its service is unreliable and inadequate, and CSX appears to be completely indifferent to Holcim's requirements and requests for service improvements. For example, CSX has refused to allow Holcim to use its private railcar fleet to transport Holly Hill's products even when CSX cannot provide its own cars to meet the needs of the plant! CSX recently eased its objection to this practice. The CSX equipment is in poor condition and is routinely rejected at the Holly Hill facility. By contrast, two other cement plants in the Holly Hill area that are not captive to a single railroad are freely allowed to ship product in private cars without the restrictions that CSX imposes on Holcim.

In addition to CSX's inadequate railcar service and its restrictions on private cars, CSX charges Holcim rates that exceed those paid by the two nearby cement manufacturers that have competitive rail service. By obtaining rail competition, through its "build out" to NSR, Holcim will place Holly Hill on equal footing with other comparable cement facilities that have access to more than one railroad.

CSX's consistently poor service, which has caused Holcim to lose business opportunities in the past, simply cannot meet the needs of Holly Hill's expanded production capacity. Holcim believes that competition between CSX and NSR at Holly Hill will produce more responsive, more reliable, and better rail service. Improved rail service will support the facility's increased production and allow Holcim to supply distant markets and to compete in new markets.

Additionally, rail-to-rail competition will lead to a reduction in rail rates, making Holly Hill more competitive with non-captive producers. Accordingly, HolRail, the Holcim subsidiary, has filed a petition with the STB to construct a two-mile rail line, running south from the Holly Hill plant to the NSR line. The petition is currently pending before the STB.

Another example of the unintended consequences of the Staggers Act involves a captive east coast cement company that must transport cement 300 miles by rail to its distribution terminal to meet customer demand. The applicable rail rate is so outrageously high the cement company concluded that importing cement from China to the east coast is less expensive than shipping it 300 miles by rail.

DEMAND FOR CEMENT TO INCREASE

United States cement consumption reached a record high during 2005, peaking at 127 million metric tons and reflecting growth of 5.6 percent over strong 2004 levels. The near term outlook for the cement market remains strong. Growth in cement consumption is expected to materialize due to continued increases in construction activity as well as increases in the use of

concrete and cement per construction dollar spent. Despite the likelihood that the growth boom in residential housing construction may be nearing an end, gains in nonresidential and public construction are emerging as new sources for growth in construction activity. Gains in these areas are expected to outweigh modest declines in residential construction – resulting in a continuation of growth in construction activity. Furthermore, various influences suggest that the increases in concrete and cement usage per dollar of construction activity will continue. The combination of sustained strength in construction activity and cement usage per dollar of construction activity is expected to result in new cement consumption records in 2006 through 2007 and beyond. From 2005's record levels, cement consumption is expected to grow 3.5 percent in 2006 and another 2.5 percent in 2007.

Cement and concrete are literally one of the building blocks of our nation's economic growth. Strong cement demand reflects the need for business to expand commerce by way of increasing its physical properties, whether it be retail shops, warehouses or office buildings. It also reflects the need for federal, state and local governments to build new schools, improve its road systems and general infrastructure. It also reflects the need to build new housing to meet growth in population and household formation. Furthermore, according to the Bureau of Census, the United States population is expected to grow by 68 million persons in the next 25 years. As a result, new demand for commercial, public and residential construction activity will increase. According to PCA's long term forecast, cement consumption is expected to grow from 127 million metric tons in 2005 to 200 million metric tons in 2030.

To meet the future U.S. cement and concrete requirements, the United States cement industry currently is engaged in its most aggressive capacity expansion in the industry's history. Based on announced and permitted plans, by 2010 the industry will add 18.6 million metric tons (20.6 million short tons) of clinker capacity – representing a 19.8 percent increase over 2005 capacity levels and a $4.1 billion commitment. The capacity expansion reflects a mix of greenfield sites, plant modernizations, and expansions of existing facilities. In addition, the industry is committed to the expansion of its import facilities – amplifying the industry's commitment to expand all sources of supply to meet the national economy's rising need for

cement and concrete. At least 63 percent of the new capacity expansion and modernizations underway at existing facilities are captive to a single railroad. Although three greenfield facilities are scheduled to start production during this period, the cement industry is largely limited to modernizing and expanding its capacity at existing facilities because of high construction and permitting costs to build a greenfield cement plant. Since cement industry capacity expansion must follow projected market demographics largely based on population growth, much of the expansion will occur in the southern and western regions of the United States where the vast majority of the cement facilities are captive to a single railroad. In short, Mr. Chairman, the cement industry is forced to expand capacity where it is captive to a single railroad – despite our industry's concern about that captivity.

While the industry has proven it commitment to providing reliable and adequate supplies of cement and concrete to meet U.S. needs, these efforts are partially offset by existing rail constraints. The existing lack of adequate rail capacity impedes portland cement manufacturers from effectively and efficiently delivering its product to the marketplace. The rail capacity shortfall relative to existing requirements of the economy is reflected in a rapid run-up in rail freight rates – rising by 11.7 percent in 2005 according to the Bureau of Labor Statistics. As the economy grows and more cement capacity is put in place, it is likely that existing rail constraints will be exaggerated, potentially leading to a repeat of the large rate hikes experienced in 2005. Furthermore, it is important to recognize that other essential building materials rely heavily on the railroads to move product to market – amplifying the adverse consequences of rail constraints on overall economic growth.

Construction currently accounts for approximately 6.7 percent of total economic activity. One out of every 18 jobs in the U.S. is directly employed by the construction industry. Since 2000, growth in construction employment has accounted for 30 percent of the United States' total employment growth. Very little construction activity can materialize without utilizing concrete at some stage of the construction project. Impairment in the ability to deliver cement to market efficiently, impairs construction activity and represents an issue that could impede future growth in this important sector of our nation's overall economic activity.

FREIGHT RAILROAD INFRASTRUCTURE TAX CREDIT

The Class I railroads state that they are committed to expanding capacity and improving service, spending an estimated $6.6 billion for capital expenditures in 2005 and projecting to spend a record $8 billion in 2006. To further enhance capital improvement and increase capacity, the Class I railroads are seeking a 25 percent federal tax credit to leverage private investment in rail infrastructure improvements and other capital expenses. The proposal reportedly would also make the tax credit available to certain shipper funded rail projects.

PCA obviously supports increasing investment in the nation's rail infrastructure to meet the current and future freight transportation needs. As the Class I railroads report profit increases, now is the time for the railroad industry to bolster investment to expand capacity and improve service, especially for captive shippers that typically pay much higher rates and experience poor to marginal service.

Without knowing the full details of the 25 percent tax credit sought by the railroad industry, PCA has not stated an official position on this proposal. PCA would be more inclined to support a tax credit if Class I railroads are required to invest in rail capacity projects that would provide relief to captive shippers. This requirement would have the benefit of reducing highway congestion, creating a more efficient freight rail system for all shippers, including particularly domestic shippers who generally are the ones that are captive, and heavy truck traffic on our highways and local streets, thus reducing highway maintenance cost. Requiring that the tax credit for rail capacity enhancements be focused on the infrastructure needed to serve captive rail customers would be the most prudent and sound use of taxpayer dollars. The cement industry also believes that Congress should further examine the concept of a railroad trust fund, similar to the Highway Trust Fund, to finance rail capacity and capital projects. Finally, we want to see any tax benefit for the railroad industry coupled with legislation that addresses the

concerns of railroad customers that the rail industry be more competitive, including that the railroad industry be subject to the same antitrust laws as the cement industry.

The higher rates and unreliable service often associated with captive cement plants often forces our industry to transport cement by bulk tank truck to distribution terminals and customers at a much higher cost. It is critical that cement manufacturers maintain adequate inventories of product to meet contractor demand. Contractors utilizing portland cement in large-scale concrete paving projects, for example, need a constant and reliable supply of cement to meet construction time tables and to plan for weather delays and other construction complications. Just as contractors expect timely shipments of cement from the cement company, it is the obligation of the railroad, we believe, to deliver shipments of cement in a timely manner.

CONCLUSION

U.S. manufacturers need a vibrant and profitable rail industry to support our nation's economic growth. The portland cement industry is a vital component of our nation's construction industry, which supports the backbone of our nation's growing economy. It is essential that the portland cement industry have access to a competitive rail transportation system to ensure that our product is delivered in a timely and efficient manner to our customers who build our nation's critical infrastructure fostering economic expansion. With more than 80 percent of the cement manufacturing plants and a similar ratio of the industry's 400 distribution terminals held captive to a single railroad, combined with the inadequate service at these facilities, only adds to our nation's construction costs. Demand for cement is forecast to increase for the foreseeable future, only exacerbating this problem.

Mr. Chairman and members of the Subcommittee, we strongly urge you to further examine H.R. 2047, *the Railroad Competition Improvement and Reauthorization Act*, especially provisions that would expand STB's authority over service-related issues. This provision, among others, would help provide some relief for captive industries, such as the cement industry.

Mr. Chairman, thank you for the opportunity to testify before the Subcommittee today on this important issue.